CASE 19

KAO CORPORATION: DIRECTION FOR THE TWENTY-FIRST CENTURY

HISTORY AND BACKGROUND

In 1887, Tomiro Nagase opened a modest shop in the heart of Tokyo selling soap and other pharmaceutical products. He named his store *Kao*, or the King of Flowers. Always focusing on the welfare of the consumer, Nagase used this motive as a way to get to the people of Japan. Then in 1890, he introduced the first product to be manufactured by Kao, called Kao Soap. By 1923, Kao opened its first manufacturing plant in Tokyo, and began to produce its Kao Soap there. From this period forward, other products began to enter into the expertise of Kao, with introduction of Kao's own shampoo, laundry detergent, scouring powder, and a liquid detergent.

During the war, like many other manufacturers, Kao felt the brunt of the conflict. However, in 1949, Kao entered a new era with a listing in the Tokyo Stock Exchange. From this point, Kao made many aggressive moves by acquiring and merging with other chemical companies, and by expanding abroad. In 1964, Kao moved into Taiwan and Thailand, marking its move to expand into Asia. Other acquisitions and moves include Dino Indonesia, Infosystems Canada Inc., Andrew Jergens in the United States, and Goldwell in Germany. Currently Kao is the largest household product manufacturer in Japan, and boasts more than 550 different products worldwide, in twenty-seven different countries. The product family overall includes personal care products, cosmetics, laundry and cleaning products, hygiene products and bath additives, food products (edible oils), floppy disks, information technology, and chemical products.

Even though most Japanese companies had difficulties in sustaining growth and profitability due to the collapse of the economic bubble and decreased consumption of the Japanese consumers, Kao continued to grow and earn profits up to the 1999 fiscal year (see Exhibit 1). Moreover, Kao's stock price has increased despite the overall decline of the Japanese stock market. Analysts in the stock market have a favorable impression on Kao, because Kao emphasizes profitability as one of the major concerns for management, unlike the typical Japanese firms that mainly focus on the growth rate and market share.

In 1998, Kao decided to withdraw from the floppy disk business, because top managers of Kao judged that the market has too many players, thus no longer being a prospective business for growth. Before the decision, Kao had a 15 percent market share in the floppy-disk market in Japan. Following this withdrawal, Kao is discussing the future of its Information Technology division as well. Top managers of Kao think that Kao may not have a competitive advantage in the IT business. In addition to the positive response to Kao's own concerns on profitability, analysts have also responded favorably to Kao's cash-flow oriented management.

KAO'S PHILOSOPHY

Living by the idea that satisfying consumers will bring the company success in the market, Kao has lived by a simple slogan, "Create products of superior quality that provide consumers with wholehearted satisfaction." This ideal has obviously moved off into other areas of business for Kao in ways that have directly affected the corporate culture. So much so, that the mission statement is quoted as follows:

> Kao's mission is to contribute to the wholehearted satisfaction and the enrichment of the lives of customers and employees throughout the world. We will accomplish this by drawing on our creative and innovative strengths to develop products of excellent value and outstanding performance. Fully committed to this mission, all members of Kao companies are working together as a single corporate force to win the loyalty and trust of their customers.

From the time when Mr. Nagase opened up his own pharmaceuticals store, this philosophy of always satisfying the customer has been Kao's credo. It has filtered down to other areas of the company as well.

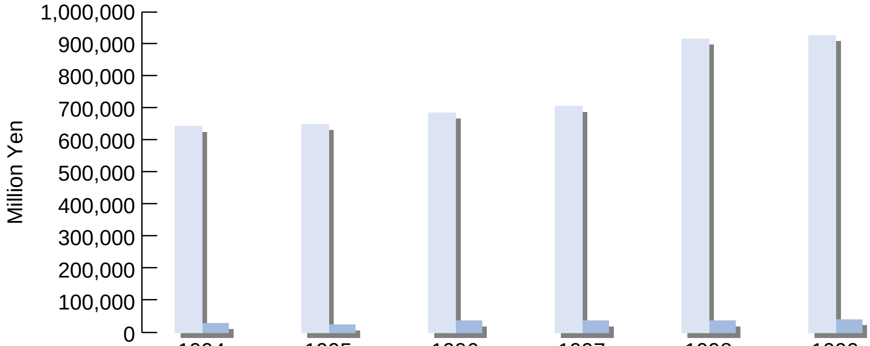
MANAGEMENT PRINCIPLES

Kao's management uses five basic principles as a guide in devising business strategies in the industry. These principles are as follows:

1. Ensure customers' wholehearted satisfaction worldwide.

This case was prepared by Jamie Kaku and SeokHo Lee of the University of Hawaii at Manoa, under the supervision of Professor Masaaki Kotabe of Temple University, as the basis for class discussion rather than to illustrate either effective or ineffective management of a situation described (August 1999).

EXHIBIT 1
SALES AND NET INCOME OF KAO CORPORATION (1990, CONSOLIDATED F/S)



	1994	1995	1996	1997	1998	1999
Net sale	642,609	653,541	675,993	705,332	907,200	924,500
Net income	22,192	23,696	24,531	27,594	24,450	34,750

2. Create innovative products based on original ideas and technologies.
3. Sustain profitable growth and respond to the trust of stakeholders.
4. Leverage the abilities of individuals into a powerful corporate force.
5. Encourage close harmony with the environment and the community.

All these principles are based on the premise of Kao's slogan and mission statement, and its focus on the customers. From here, other areas of these principles begin to take shape with the employees and other stakeholders that Kao would have.

PRODUCT DEVELOPMENT AND R&D

As part of Kao's goal to continually satisfy their customers, product innovation is a key focus. The current president of the Kao group, Takuya Goto, stated that "a strong brand needs to be supported by R&D'' (Annual Report). To ensure product innovation and development, this department follows four basic guidelines:

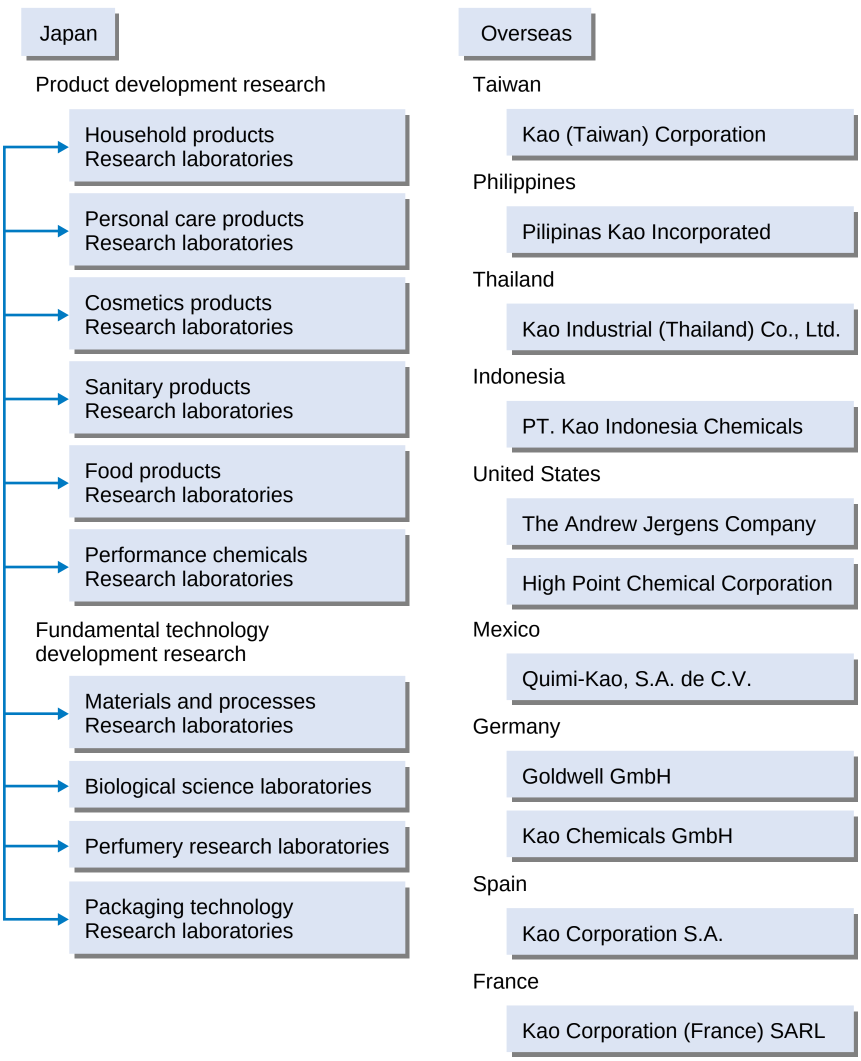
- Base all new developments on scientific discovery.
- Always seek to improve on products.
- Become the first in the market with an innovative product.
- Create a product that will bring the most satisfaction to the customer.

With this basis in mind, Kao also uses a product developmental format in which all departments are in contact with each other, thus focusing on an aggregate company product innovation and customer satisfaction (see Exhibit 2). This also helps them to keep in touch with the importance that Kao holds on environmental issues when producing their product.

As Kao continues to search out the needs of consumers, marketing research becomes the focus for the corporate activities. For this purpose, Kao operates a consumer Information center, called the *Echo system* (see Exhibit 3). This system allows it to do marketing research systematically as a product is being produced. Kao's consumer center has pools of consumer inquiries, and receives comments from them on a daily basis. The collected information gathered by the Center is accessible to all sections within the company. In addition, through establishing an information network system that functions online between the head office of Kao and *Hansha* (sales companies handling Kao products exclusively), Kao can get market information on current trends. This marketing research system has allowed Kao to trace and respond to market trends quickly.

Uncharacteristic of a Japanese corporation, Kao has a lot of local-based R&D divisions, primarily due to the different features that are required in different areas of the world. For Kao, it is important to ensure that the production and marketing of its products are both attractive and beneficial to each of its local consumers.

EXHIBIT 2
R&D CENTER LOCATION



BRAND POWER

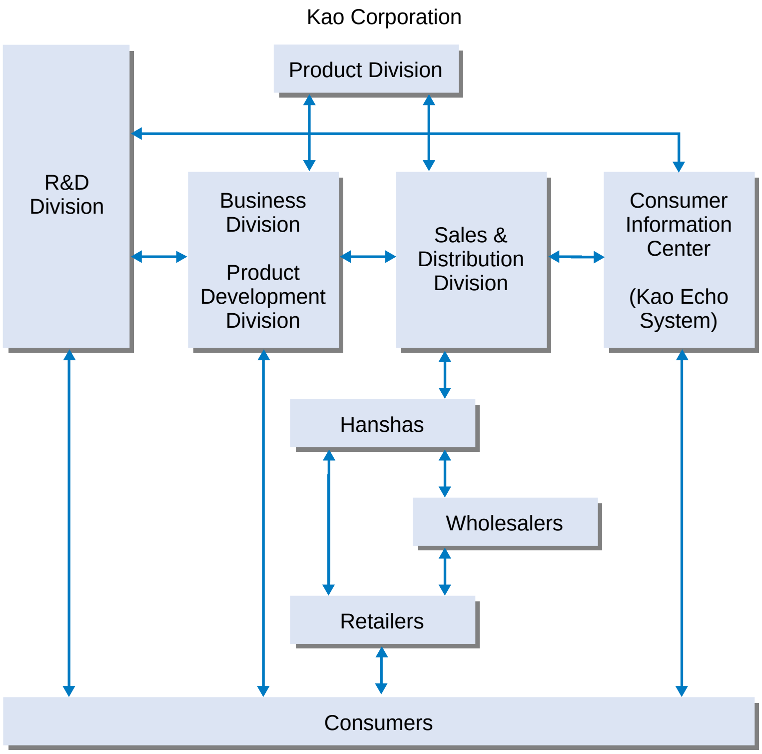
Probably one of Kao's greatest strengths lies in its brand power. According to the Nikkei Research Institute of Industry and Markets (operated by Nihon Keizai Shinbun), *brand power* is determined by a power-ranking survey of consumers' opinions. This survey takes a look at the 170 leading brands in the market, in nineteen different product categories, and examines factors like brand recognition, perceptions of the product's quality, and feelings of loyalty to those brands.

According to this survey, Kao's laundry detergent *Attack* had the highest rating (see Exhibit 4). Launched in 1987, Attack was considered to be breakthrough product that combined compact packaging with extra-cleaning power. In addition to Attack, Kao had four other brands listed in the top twenty of the "Brand Power Ranking'' (see Exhibit 4). These products are in the categories of shampoo/conditioner, dishwashing detergent, sanitary napkins, and cosmetics.

EXPANDING INTO THE U.S. MARKET

Andrew Jergens has been a household name in the United States for decades. Founded with $5,000 as The

EXHIBIT 3
ECHO SYSTEM



Andrew Soap Company in 1882 and headquartered in Cincinnati, Ohio, Jergens has become one of the most recognized brands in skin care in the United States. Jergens' products are sold in fifty-six countries, with the majority of sales in North America. Jergens has led the U.S. market with innovations such as *Jergens' Body Shampoo* and *Pore Perfect*. Its cherry-almond smell is synonymous with the company, and comfortingly familiar to most Americans. In the 1950s, the company enjoyed a 70 percent market share in the skin care product business, and Hollywood stars such as Elizabeth Taylor and Lucille Ball advertised its products.

In 1970, the family-owned company was sold to American Brands, becoming a part of a huge conglomerate that also sold tobacco, alcohol, and food. The company was run purely for profit, and suffered a lack of capital investment, but bumbled along until the late 1980s. From that point, American Brands decided to diversify and put Jergens up for sale.

At about the same time, Kao was looking for an American distributor for its skin-care products. Kao's gross sales hovered at approximately 4 billion yen. Kao succeeded in the Asian market, but had difficulties establishing itself in the United States. Since, Kao was without a distribution arm in the United States, it set up an office in New York, hired consultants, and started looking for a company to work with. Coincidentally, Jergens came onto the market at about the same time. George Sperzel, Andrew Jergens' CFO, stated, "Kao had developed the first concentrated laundry detergents, which were a huge success in Asia and Japan. But it hadn't expanded globally beyond South-East Asia, and its products were copied and quickly developed by other companies in Europe and the United States.'' Being fully aware of this, finding a local partner became even more of an imperative to Kao.

Interestingly, Jergens' expertise in skin care was largely irrelevant to Kao at the time. What mattered was that it had a sales and distribution system. In fact, the two companies complemented each other better than either could have imagined. Thus far, Jergens has had success with both the Biore line and Kao's liquid body cleansers, while Kao has launched the Jergens' skin-care products in Japan, hence tapping into a whole new market.

GEORGE SPERZEL

George Sperzel joined Jergens about five years after the purchase, while previously spending most of his career

EXHIBIT 4
BRAND POWER RESEARCH RESULTS BY NIHON KEZAI SHINBUN

"Brand Power Ranking" (Top 20 Brands)				
Rank	Brand name	Product category	Points	Company name
1	Attack	Laundry detergent	83.0	Kao Corporation
2	Kleenex	Tissue paper	78.3	CRECIA Corporation
3	Cup Noodle	Instant cup noodles	75.0	Nissin Food Products Co., Ltd.
4	Whisper	Sanitary napkin	73.2	Procter & Gamble Far East, Inc.
5	Asahi Super Dry	Beer	69.6	Asahi Breweries, Ltd.
6	Pabron	Cold medicine	68.6	Taisho Pharmaceutical Co., Ltd.
7	Handycam	Video camera	67.2	Sony Corporation
8	Meiji Milk Chocolate	Chocolate	67.0	Meiji Seika Kaisha, Ltd.
9	Merit	Shampoo-conditioner	66.9	Kao Corporation
10	Kirin Ichiban Shibori	Beer	66.8	Kirin Brewery Company, Limited
11	Lulu	Cold medicine	65.7	Sankyo Co., Ltd.
12	Family Fresh	Dishwashing detergent	65.2	Kao Corporation
12	Laurier	Sanitary napkin	65.2	Kao Corporation
14	Kirin Lager Beer	Beer	64.4	Kirin Brewery Company, Limited
15	Georgia	Canned coffee	64.3	Coca Cola (Japan) Ltd.
16	Aisalgo	Washing machine	63.8	Matsushita Electric Industrial Co., Ltd.
17	Kirigamine	Air conditioner	63.2	Mitsubishi Electric Corporation
17	Sofina	Cosmetics	63.2	Kao Corporation
19	Scottie	Tissue paper	62.4	CRECIA Corporation
20	Elleair	Tissue paper	61.8	Daio Paper Corporation

(Courtesy of the Nikkei Marketing Journal, September 6, 1997)

with General Electric. It was GE's rigorous training and management style that Jergens particularly sought for in its new CFO.

> I met with the Japanese president of the company at that time, and he talked for about two hours. At the end of it, I said, "Don't you want to hear about me?'' and he said no, because he knew GE's reputation and just wanted to be sure that I would fit in. The parent company is "supportive but hands off,'' with the minimum of corporate bureaucracy. They rely more on the judgment of the management team when it comes to decision-making due to my experience with U.S. companies. As far as processes and policy, I'm completely free to do what I want, which is how it should be.

As it turned out, there was plenty to do upon his arrival. Finance had a very small role in the company, mainly just a reporting role, and was not even represented on the executive committee. They stayed on their floor of the administration buildings, producing reports that they then threw over the wall to someone else. Mr. Sperzel said "The idea was that I would bring the finance function into the 1990s.'' He immediately set about upsetting the company's habit of operating in *functional silos* (a term derived from the farming community in Cincinnati, where the company is based).

> The sales, marketing and other functions didn't really talk to each other except at the very top. So if someone in finance had a marketing question, they would go up the line to the VP (vice president) of finance, over to the VP of marketing, and down the line to whoever knew the answer. Within the first two weeks, I took the best two finance people and said, starting Monday you're working in marketing. The marketing people really liked it. The finance people were unsure. But from my experience with GE I knew that it worked better than anything. The company is now organized into production teams, with marketing, sales, and R&D and finance all represented and seated together. We've also sent finance people into the manufacturing and IT systems operations. The end result is that we are able to contribute at the beginning of a project. Before, finance

> only had a chance to comment at the end, when it was too late, and it came across as nit picking, or hindsight. We're now viewed as a support member of the team rather than an observer . . . A lot of people were uncomfortable with people questioning what they were doing. Arguing was encouraged at GE because people come up with a better answer than if you go for a consensus, which is of course the traditional Japanese way of doing things. There was no interaction, but now everyone challenges everything, in a cooperative rather than a hostile way.

The company had undergone another transformation in 1995, when Bill Gentner was brought in from Unilever as president, replacing the Japanese president, who became the managing director of Kao. One of Gentner's first moves was to essentially restructure the entire management team. George Sperzel ended up being the only one left in an executive role when all the changes were said and done. Sprezel explains the situation as such:

> Bill Gentner has brought in a lot of people from big companies. Although Jergens is very small, we know what a big company looks like. We have a clear goal of where we want to go, but because we're small we can be fast and flexible about getting there. We also get our hands a lot dirtier than we did at the bigger companies.

BIORE STRIP

The biggest event in Jergens' recent history, though, is the Biore strip. This skin-cleansing strip of paper was launched by Kao in Japan in May of the previous year. There are many differences between the Japanese market and its U.S. counterpart, particularly so in the skin-care business. (As it is very humid in Japan, dry skin isn't an issue.) Biore, marketed as a mid-priced family brand in Japan, was repackaged for the U.S. market, and directed to an entirely different audience. Jergens seized the opportunity to develop an entirely new brand under the Biore name, which would draw in a much younger audience than its products and in the past.

> We wanted to use the strips as a way to develop a new category—facial care—that we weren't in already. Andrew Jergens is seen more as a product targeted toward women of 35 and above, but this was a way of getting to the younger age group, which is a neglected territory.

The strips were patented, but it was still only a matter of time before similar products were launched by rival companies—Unilever's Ponds brand, for instance, a major rival, has already launched its own version. Jergens' lack of size compared to P&G and Unilever makes it difficult to compete on any grounds other than constant innovation. Sprezel went on stating, "We won't get into an advertising war because they have resources that we don't. The business is pretty cut-throat, but if you have good products it doesn't matter how big or small you are.'' Jergens' sales amounted to 24 billion yen (US$180.4m) in the 1996 financial year and 30.5 billion yen (US$229.2m) in 1997. Much of that increase can be attributed to Biore. Sales of the Biore products alone are expected to reach 22.5 billion yen (US$169.1m) in 1998. Jergens' has also recently bought two established brands, Curel and Soft Sense, from Bausch & Lomb, which it hopes to add to the skin-care lines' profitability. There is a strong sense of making the most of Biore while the market is still somewhat active. So far the strips continue to sell, and the range of new Biore-branded facial products launched on the back of its success show every sign of continuing its high profile. "This was a once in a lifetime, a once in a career product,'' Mr. Sperzel says, "But we're not going to wait and find out how long this will last. We are constantly looking for new products.''

ANALYSIS

Kao is an extremely innovative Japanese company. Procter & Gamble, a much larger U.S. competitor, uses it as a benchmark for its product development in areas of personal care products, cosmetics, and laundry and cleaning products, among other things. Yet, Kao's foreign expansion, albeit aggressive, has not produced results of a kind that Sony and Honda, two comparable Japanese companies, enjoy. According to Kao's recent annual report, there are five areas in which the company would like to focus on in entering the twenty-first century: (1) concentrate on core businesses (2) continue to develop innovative products, (3) increase brand power, (4) use cash-flow oriented management, (5) develop new businesses, and (6) continue to improve operations. Given Kao's corporate objectives, address the following issues:

1. Is the company's current strategy with Jergens sufficient for its expansion and building brand recognition in the U.S. market?
2. Kao's Attack is the most innovative laundry detergent with unparalleled cleaning power introduced in the world. Yet, it has not been introduced in other major markets such as the United States and Europe. Why is Kao slow in introducing such an innovative product around the world?
3. Was the company's decision to pull out of its profitable disk business a wise one despite its admirable market share position? How about other information technology areas that it has invested in?

ADDITIONAL EXHIBITS

EXHIBIT 5
SALES COMPARISON WITH COMPETITORS (1997)

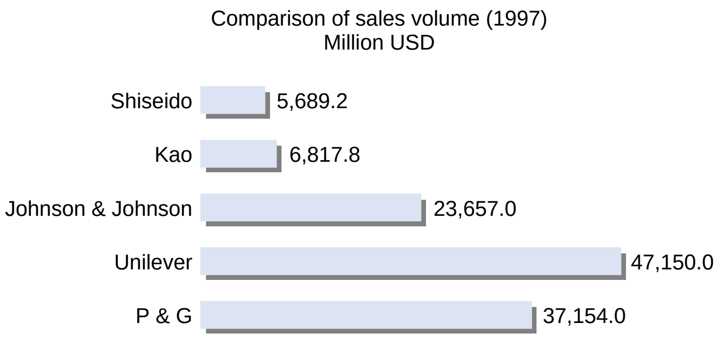


EXHIBIT 6
SALES BY INDUSTRY

	Billions of Yen					
	SALES			*OPERATING INCOME*		
Year ended March 31	**1999**	*1998*	*% change*	**1999**	*1998*	*% change*
Household Products	**730.6**	696.7	4.9	**85.7**	77.5	10.7
Chemical Products	**193.9**	210.4	(7.8)	**5.8**	(4.6)	N/A
Total	**924.5**	907.2	1.9	**91.6**	72.8	25.8

	Millions of U.S. Dollars					
	SALES			*OPERATING INCOME*		
Year ended March 31	**1999**	*1998*	*% change*	**1999**	*1998*	*% change*
Household Products	**6,060.9**	5,780.2	4.9	**711.7**	642.9	10.7
Chemical Products	**1,608.9**	1,745.7	(7.8)	**48.7**	(38.5)	N/A
Total	**7,669.8**	7,525.9	1.9	**760.4**	604.5	25.8

EXHIBIT 7
BUSINESS PORTFOLIO OF KAO CORPORATION (1999)

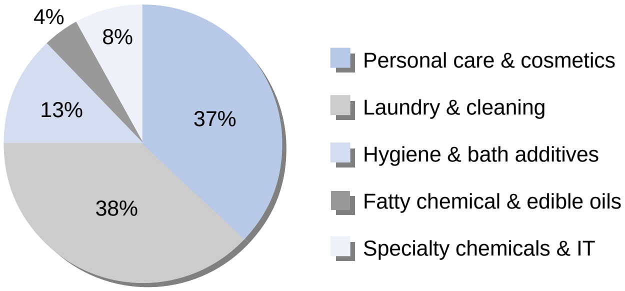


EXHIBIT 8
SALES BY REGION

	Billions of Yen					
	SALES			*OPERATING INCOME*		
Year ended March 31	**1999**	*1998*	*% change*	**1999**	*1998*	*% change*
Japan	**672.1**	674.6	(0.4)	**80.9**	71.6	12.9
Asia	**104.6**	101.7	2.9	**5.3**	7.4	(28.3)
Europe and Americas	**178.9**	162.0	10.4	**5.3**	(6.2)	N/A

	Millions of U.S. Dollars					
	SALES			*OPERATING INCOME*		
Year ended March 31	**1999**	*1998*	*% change*	**1999**	*1998*	*% change*
Japan	**5,575.5**	5,596.4	(0.4)	**671.4**	594.5	12.9
Asia	**868.5**	843.8	2.9	**44.5**	62.1	(28.3)
Europe and Americas	**1,484.3**	1,344.6	10.4	**44.7**	(51.9)	N/A